U.S. Department of Labor

Employee Benefits Security Administration
Washington, D.C. 20210

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U.S. DEPARTMENT OF LABOR SUPPLEMENTAL STATEMENT ON PRIVATE EQUITY IN DEFINED CONTRIBUTION PLAN DESIGNATED INVESTMENT ALTERNATIVES

This statement supplements the Department of Labor's June 3, 2020 Information Letter regarding the use of private equity (PE) investments in designated investment alternatives made available to participants and beneficiaries in individual account plans, such as 401(k) plans, subject to the Employee Retirement Income Security Act of 1974 (ERISA).[1]

The Information Letter stated that a plan fiduciary would not, in the Department's view, violate the fiduciary's duties under section 403 and 404 of ERISA solely by reason of offering a professionally managed asset allocation fund with a PE component as a designated investment alternative subject to important conditions set forth in the letter. Rather, the Information Letter confirmed that, as with any plan investment, plan fiduciaries must determine that an investment that includes PE is, among other things, prudent and made solely in the interest of the plan's participants and beneficiaries.

Importantly, the Information Letter did not endorse or recommend such investments. Rather, the Information Letter noted that PE investments tend to be more complicated, with longer time horizons, are typically less liquid, and are subject to different regulatory standards and disclosure rules than other more traditional individual account plan investment options. In addition, the Information Letter noted that the valuation of PE investments is more complex and their fees are typically higher. The Information Letter stated that when ERISA-covered plan fiduciaries consider any investment for an individual account plan menu, they must engage in an objective, thorough, and analytical process that evaluates anticipated opportunities for investment diversification and enhanced investment returns, as well as the complexities associated with the PE component. Further, the Information Letter stated that fiduciaries should compare the fund with funds that do not include PE. The Information Letter noted that the Department had previously observed, in the case of other complex investments, that plan fiduciaries are responsible for securing sufficient information to understand the investment and its attendant risks, prior to making the investment.[2] The Information Letter also identified a list of factors that plan fiduciaries should consider in evaluating whether to include an investment vehicle with a PE component as a designated investment alternative, noting that the use of these investments in participant-directed individual account plans presents considerations that are different from those involved in defined benefit plans.

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[1] The Information Letter, dated June 3, 2020, was issued to Jon W. Breyfogle as the representative of Pantheon Ventures (US) L.P. and Partners Group (USA), Inc., and is available at www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020. The Information Letter addressed the use of private equity investments within professionally managed asset allocation funds designated as investment alternatives for participant-directed individual account plans. In no case would the private equity component of the asset allocation fund be available as a vehicle for direct investment by plan participants and beneficiaries on a stand-alone basis. The Information Letter cautioned that direct investments in private equity investments present distinct legal and operational issues for fiduciaries of ERISA-covered individual account plans.

[2] See Information Letter from Olena Berg to Eugene A. Ludwig (Mar. 21, 1996) (at www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/03-21-1996).

The Department received questions and reactions from a range of stakeholders regarding the Information Letter. In addition, a "Risk Alert" issued by the Securities and Exchange Commission's Office of Compliance Inspections and Examinations shortly after the Information Letter was issued in June 2020 highlighted compliance issues in examinations of registered investment advisers that manage PE funds or hedge funds.[3] The Risk Alert addressed three areas: conflicts of interest; fees and expenses; and policies and procedures relating to material non-public information. After carefully considering the stakeholder input and the implications of the SEC Risk Alert, the Department concluded that it should supplement the Information Letter to ensure that plan fiduciaries do not expose plan participants and beneficiaries to unwarranted risks by misreading the letter as saying that PE—as a component of a designated investment alternative—is generally appropriate for a typical 401(k) plan.

First, the Department agrees with some stakeholders that the recitation in the Information Letter of representations by the requester regarding the claimed benefits of PE investments reflected the perspective of the PE industry; the representations were not balanced with counter-arguments and research data from independent sources. For example, some stakeholders expressed concern about representations that designated investment alternatives with a PE component "offer plan participants who have longer investment horizons an equities-based investment choice that may enhance retirement outcomes when compared to investment choices containing only publicly traded securities." The stakeholders challenged this assertion and warned that performance calculations must be carefully analyzed because they are not standardized or regulated like disclosures from registered investment companies (mutual funds). The stakeholders expressed concerns about the adequacy of investment disclosures that would be provided to participants and beneficiaries who may not have specialized investment education and experience. The stakeholders also observed that retirement savers may often need to liquidate or transfer these assets at an earlier stage than many long-term investors, especially workers that frequently change jobs.

Second, as noted above, the Information Letter explained the Department's expectations regarding the expertise plan fiduciaries should possess to be able to satisfy their duty under ERISA to prudently select and monitor PE as a component of a designated investment alternative. The Department stated that, as with any designated investment alternative, the plan fiduciary must consider whether the fiduciary has the skills, knowledge, and experience to make the required determinations or whether the plan fiduciary needs to seek assistance from a qualified investment manager or other investment professional. For example, the Information Letter pointed out that the responsible fiduciary should be able to determine, either alone or with the assistance of a qualified adviser, whether the particular investment arrangement complies with applicable requirements under securities, banking, or other relevant laws and regulations. Stakeholder concerns about the ability of the sponsoring employer and other plan-level fiduciaries in a typical 401(k)-type plan to fulfill these obligations led the Department to conclude that it should emphasize those parts of the letter.

It is important to note that the Information Letter responded to concerns raised by the requesters about plan fiduciaries who offer both defined benefit and defined contribution plans, and who may invest in PE for their defined benefit plans, but do not do so for the participant-directed individual account plans out of fear of liability. A plan-level fiduciary that has experience evaluating PE investments in a defined

[3] Risk Alert, Observations from Examinations of Investment Advisers Managing Private Funds, SEC Office of Compliance Inspections and Examinations (June 23, 2020)("Many of the deficiencies discussed below [in Risk Alert] may have caused investors in private funds ('investors') to pay more in fees and expenses than they should have or resulted in investors not being informed of relevant conflicts of interest concerning the private fund adviser and the fund. This Risk Alert is intended to assist private fund advisers in reviewing and enhancing their compliance programs, and also to provide investors with information concerning private fund adviser deficiencies.")(at www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf).

benefit pension plan to diversify investment risk may be suited to analyze these investments for a participant-directed individual account plan, particularly with the assistance of a qualified fiduciary investment adviser. The Department cautions against application of the Information Letter outside of that context. Except in this minority of situations, plan-level fiduciaries of small, individual account plans are not likely suited to evaluate the use of PE investments in designated investment alternatives in individual account plans. The Department further notes that ERISA section 404(c) does not relieve a plan fiduciary of the prudence duties that apply to the selection and monitoring of designated investment alternatives, investment managers and investment advice service providers. *See* 29 CFR 2550.404c-1(d)(2)(iv).

Parties with additional questions may contact the Employee Benefits Security Administration's Office of Regulations and Interpretations at 202-693-8500.